

ST 00-16

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE, as
Responsible Officer of
DOE BISTRO, Inc.**

No. 98-ST-

NPL No.

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Harold Moskowitz, appearing on behalf of JOHN DOE, Mr. Marc Muchin, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to JOHN DOE' (hereinafter "DOE") protest of Notice of Penalty Liability No. XXXX (hereinafter the "NPL"), as responsible officer of DOE BISTRO, Inc. (hereinafter "BISTRO") The NPL represents a penalty liability for Retailers' Occupation Tax of BISTRO due to the Department for the months of March through September of 1996. A hearing was held on this matter on February 24, 2000, with DOE providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that

the NPL issued against DOE be finalized. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No XXXX, which shows a penalty for tax liability of BISTRO in the amount of \$56,686.58, including interest calculated through November 12, 1997. The NPL covers the months of March through September of 1996. Dept. Ex. No. 1.
2. DOE first met with JIM DOE (hereinafter “JIM DOE”) in late 1994 to discuss opening a new restaurant. BISTRO opened in April of 1995, and remained open for approximately 18 months. Tr. pp. 10-11, 14.
3. DOE initially owned 100% of BISTRO’s stock. After DOE and JIM DOE decided to become partners, 25% of the stock was issued to JIM DOE. JIM DOE was the secretary and DOE was the president of BISTRO. Tr. pp. 28, 68-69.
4. From the time that DOE met JIM DOE, in late 1994, until BISTRO opened in April, 1995, DOE helped JIM DOE get contractors, equipment suppliers and furniture. After BISTRO opened, DOE was there for one or two weeks to check on the service and the quality of the food. Tr. pp. 70-71.
5. DOE has been in the restaurant business for 10 years. He was president, manager and 75% owner of DOE Café, Inc. while BISTRO was open. DOE was owner and president of DOE Restaurant in SOMEWHERE and part owner and president of DOE’S Kitchen and Tap in SOMEWHERE. Tr. pp. 8-9, 30, 63-65.

6. The “Shareholders’ and Management Agreement” for BISTRO, dated January 10, 1995, and signed by DOE and JIM DOE states in Article VI, entitled “MANAGEMENT AND OPERATION OF CORPORATE BUSINESS,” under (a), “JIM DOE’s Duties,” that “[H]e (JIM DOE) shall manage the day to day operation of the business subject to the approval of JOHN DOE. The parties further agree that any dispute between the Shareholders shall be resolved by the decision of RON DOE.” RON DOE was DOE’s father in law. Tr. pp. 10, 77; Dept. Ex. No. 2.
7. JOE DOE, of JOE DOE & Associates, was the accountant for BISTRO and DOE Café. JOE DOE would go to BISTRO once a month and collect the prior month’s sales reports. He would then calculate the sales tax, fill out the required form, and mail it back to BISTRO for signature and for mailing with a check to the Department. DOE never asked JOE DOE during the audit period whether the sales tax returns had been mailed back to the State. JOE DOE also prepared the corporate tax returns for BISTRO. Tr. pp. 13, 24-25, 51-52, 78, 82-83, 114-115.
8. When DOE would have dinner at BISTRO in the evening, the restaurant was busy and full. Tr. pp. 48-49.
9. Cash registers were used at BISTRO to record sales. Credit card sales were automatically deposited in the corporate bank account. Cash receipts were deposited daily in the account. Tr. pp. 79-80.
10. DOE and JIM DOE had the authority to sign checks. Tr. pp. 90-91.
11. The “NUC-1 Illinois Business Registration,” signed by DOE on March 15, 1995, lists DOE as president and JIM DOE as secretary and treasurer. On question 14 of the form,

DOE accepted “personal responsibility for the filing of returns and the payment of taxes due.” Tr. pp. 94-97; Dept. Ex. No. 3.

12. BISTRO’s “U.S. Corporation Income Tax Return” for the period of October 1, 1995, through September 30, 1996, was signed on September 18, 1997, by DOE as “president.” Tr. pp. 97-99; Dept. Ex. No. 4.

Conclusions of Law:

The sole issue to be decided in this case is whether DOE should be held personally liable for the unpaid retailers’ occupation tax of BISTRO. The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section.
35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that DOE was a "responsible" officer and the fact that he "willfully" failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the presumption of liability through sufficient evidence that the person was either not a responsible officer or employee, or that his actions were not willful. *Id.*

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I have concluded, based on the testimony and evidence admitted at the evidentiary hearing, that DOE was a responsible party under the statute. DOE testified that he was the president of BISTRO and a 75% shareholder. Tr. pp. 28, 68-69. DOE held the position of president during the seven months covered by the NPL. He signed the "NUC-1, Illinois Business Registration" as president on March 15, 1995, and accepted "personal responsibility" for the filing of returns and the payment of taxes due. Dept. Ex. No. 3. DOE also signed the final tax return for BISTRO on September 18, 1997, and listed his title as "president." Dept. Ex. No. 4.

DOE testified that JIM DOE was in charge of corporate cash, and in charge of depositing cash receipts. Tr. p. 29. According to DOE, JIM DOE controlled the corporate book and records and kept a ledger account of BISTRO's payables. Tr. pp. 13, 52. DOE testified that he and JIM DOE both had the authority to sign checks. Tr. pp. 90-91. When BISTRO was first opened, DOE

“wrote the first five checks.” DOE testified that he did not write checks while the restaurant was open, but he “wrote one or two checks to close the account out.” Tr. p. 14. No checks were admitted as evidence at the hearing. DOE testified that he left a message on JIM DOE’s answering machine saying, “I would like all the cancelled checks from the restaurant, from the business,” but he did not receive a response. Tr. p. 27. DOE did not call JIM DOE as a witness.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473, (E.D.N.Y. 1981), aff’d, 671 F.2d 492 (2d Cir. 1982). If DOE allowed JIM DOE to make decisions as to what creditors were to be paid, and chose not to be involved in the day-to-day operations of BISTRO, this does not make him less of a responsible officer. Although DOE shared the responsibility for check signing with JIM DOE, this does not mean that DOE himself was not responsible and the statute does not confine liability to only one person or to the person most responsible.

Additionally, while BISTRO’s “Shareholders and Management Agreement” states clearly that JIM DOE was to “manage the day to day operation of the business,” he was to do this “subject to the approval of JOHN DOE.” Dept. Ex. No. 2. I must conclude based on this agreement, that if JIM DOE had control over cash receipts, corporate books and records, and if JIM DOE determined the priority of the payment of creditors, then these practices were approved by DOE. Moreover, DOE had the authority to write checks on the corporate account and could have written a check for taxes. Responsibility is a matter of status, duty and authority, not necessarily knowledge. Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979). With the status of a 75% shareholder and president of BISTRO, with the authority to write checks, and with JIM DOE operating the restaurant subject to his “approval,” DOE was a responsible officer of BISTRO.

Throughout the evidentiary hearing, DOE testified to his lack of involvement in the day-to-day operations of BISTRO. DOE testified that he did not have a key to the outside door of BISTRO and that even though he was president, he could not enter the premises unless someone let him in. Tr. p. 102. DOE did not remember signing corporate tax returns. Tr. p. 19. DOE testified that BISTRO's books and records, including the checkbook, were kept by JIM DOE in an office at the restaurant and DOE did not have a key. Tr. pp. 49, 99-100. DOE remembered being in the office, but he was never in the office alone. Tr. p. 51.

DOE testified further that BISTRO's mail, including the bank statements, was sent to the restaurant, but DOE did not know "who was taking it." DOE testified that he did not take the mail, and does not recall being at the restaurant when the mail came. Tr. p. 50. According to DOE, he never looked at the bank statements and never asked JIM DOE if he could look at them. Tr. p. 81. DOE testified that he did not know if cash was deposited in the bank account during the audit period and he did not make any effort to find out. Tr. p. 80. DOE was asked if, during the period covered by the NPL, he had checked on JIM DOE "as to what he was doing every month." He responded "no," "because I would talk to him and he would tell me the sales were good and everything was being paid, so I took his word that there were no problems at the restaurant." Tr. p. 89. DOE also testified that he did not call JOHN DOE "to check on the status of whether the sales tax returns were going to be filed during the audit period." Tr. pp. 114-115.

DOE's testimony as to his total lack of involvement in the restaurant is not credible. On the contrary, the evidence shows that DOE had control of the business and intended to maintain control with the "Shareholders and Management Agreement" which required that the business be operated subject to his approval. Dept. Ex. No. 2. DOE testified that JIM DOE was a "well known chef" when DOE met him but there was no evidence that JIM DOE had any experience operating a

restaurant. Tr. p. 10. DOE, on the other hand, was an experienced businessman with three restaurants, in addition to BISTRO. DOE was “aware from his experience with other restaurants” that sales tax had to be paid monthly. Tr. p. 81. He also testified that BISTRO grossed around \$90,000 to \$95,000 per month, which was “better than average.” Tr. pp. 31-32.

In light of this testimony, it is not credible that DOE would completely turn over the operation of the restaurant to a chef, with 25% ownership, and no known business experience. It is also inconceivable that in the seven months covered by the NPL, DOE never once questioned whether sales taxes were being paid, never once checked BISTRO’s bank statements to see if taxes had been paid to the State, and never once asked the accountant if he knew whether the sales tax returns were being filed.

The evidence shows therefore that DOE was in a responsible position with BISTRO in which he knew or should have known whether returns were filed and sales taxes paid. Based on the forgoing, DOE has failed to rebut the Department’s *prima facie* case that he was a responsible officer of BISTRO.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept. of Revenue, 168 Ill.2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness.

DOE attempted to rebut the presumption of willfulness by testifying that he was not involved in the day to day operations of the restaurant, that he did not check on the status of the sales tax returns, and further, that JIM DOE was responsible for the payment of taxes. Although I found this testimony to not be believable, assuming *arguendo* that it was true, it would not rebut the presumption of willfulness. Responsible officers are liable if they delegate bookkeeping duties

to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the retailers' occupation tax returns and payments. Branson, *supra* at 267.

The facts are that on the "NUC-1," DOE accepted personal responsibility for the filing of returns and the payment of taxes. Dept. Ex. No. 3. DOE had the authority to write checks and in the seven month period covered by the NPL, he could have written a check for taxes. The "Shareholders and Management Agreement" required that BISTRO be managed, "subject to the approval of JOHN DOE." Dept. Ex. No. 2. I must conclude, therefore, that with DOE' control over business operations, when the sales taxes were not paid, they were not paid with DOE' approval, and this satisfies the willful requirement of the statute.

Furthermore, DOE was asked whether he wrote any checks on the BISTRO checking account during the eighteen months that the restaurant was in business. He responded:

I wrote in the very – in the beginning I wrote the first five checks. After that I did not write anything, and after Don JIM DOE closed the doors, then I think I wrote one or two checks to close the account out, but I don't think there was much there. Tr. p. 14.

No evidence was admitted at the evidentiary hearing to show what assets or money was available at the time DOE closed down the business. No evidence was admitted showing what assets were collected in winding down the business. No evidence was admitted showing the priority of claims against BISTRO or how these claims were paid. No evidence was admitted showing whether there was a final distribution of BISTRO's assets to DOE, or to whom the final "one or two checks" were written.

A person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985). In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent,

probable and identified with the corporation's books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st. Dist. 1987). Without any evidence as to the final distribution of BISTRO's assets, and knowing that the State was not paid its sales taxes, I must conclude that other creditors or the shareholders were preferred over the State, further showing willfulness on DOE's part. Accordingly, DOE has not rebutted the Department's prima facie case that he willfully failed to pay the sales tax.

DOE testified that when he received the NPL in November of 1997, he signed and mailed the sales tax returns to the State "without payment so the State would know what the correct numbers were." Tr. pp. 25-26. According to DOE's counsel, mailing in the tax returns "goes to the good faith acts taken by this particular taxpayer after discovery of the tax situation of the corporation and what he did ... to rectify the situation." Tr. p. 20. A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. 86 Ill. Adm. Code § 700.400(c). I have considered DOE's arguments with regard to "good faith." Based on DOE's testimony at the evidentiary hearing, I am unable to conclude that he acted with "ordinary business care and prudence" during the seven month period covered by the NPL.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. XXXX be finalized as issued.

ENTER:

May 1, 2000

Kenneth J. Galvin
Administrative Law Judge